



The World Bank

LAO PDR

ECONOMIC MONITOR



The World Bank Vientiane Office

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BACKGROUND

With an estimated per capita income of US\$320 in 2003 (see table 1), the Lao People's Democratic Republic (Lao PDR) is one of the poorest countries in the East Asia region. It is classified by the UN as a Least Developed Country (LDC). Today, nearly 73 percent of its population live on less than US\$2 a day, and 25 percent live on less than US\$1 a day (see *East Asia Update*, Nov 2004). Using Lao PDR national poverty line (of approximately \$1.5 a day) the incidence of poverty has fallen from 46 percent in 1992/93 (first household survey) to around 33 percent in 2002/03 (preliminary results of latest survey) – a significant decline in poverty by most standards. The social indicators have improved too, but they remain among the worst in the region, and close to the average for Sub-Saharan Africa.

Lao PDR has a population of around 5.7 million and a land area of 236,800 square km. It has significant natural resources like forestry, minerals and hydro-electric power. Agriculture is the major sector contributing 51 percent of GDP and employing 80 percent of the labor force; the industrial and service sectors account for the rest (23% for industry and 26% for services). Landlocked, Lao PDR is in the center of the Mekong region, bordered by Thailand, Vietnam, Southern China, Cambodia and Myanmar, with the first three growing rapidly.

Lao PDR has grown strongly and reduced poverty significantly for more than a decade. In the 1990s, real GDP grew by an annual average rate of 6.3 percent - despite the sharp fall-off in growth during the regional crisis of 1997-1999 period. Exports grew at around 15 percent a year. Agriculture grew rapidly as did industry and services. Donors provided considerable financial and technical support; in 2002/03, donor-funded programs accounted for 7 percent of GDP, 39 percent of total public expenditure, and 61 percent of the capital budget.

Transition to market.

The Government introduced the "New Economic Mechanism" (NEM) in 1986, to begin the transition from a centrally planned to a market-oriented economy.

Gradually, price controls were removed, farmers were allowed to work on their plots, the exchange rate system was unified, government's monopoly on trade removed the number of state-enterprises reduced, and private firms allowed.

Reforms stalled during the regional crisis, as Lao struggled with serious macroeconomic problems.

Successful stabilization began in 2000 and structural reforms revived in 2001.

Table 1. Lao PDR, EAP and Lao-income World: Comparing Development Indicators

POVERTY and SOCIAL	Lao PDR	East Asia & Pacific	Low-income
2003			
Population, mid-year (millions)	5.7	1,855	2,310
GNI per capita (Atlas method, US\$)	320	1,080	450
GNI (Atlas method, US\$ billions)	1.8	2,011	1,038
Average annual growth, 1997-03			
Population (%)	2.3	1.0	1.9
Labor force (%)	2.3	1.1	2.3
Most recent estimate (latest year available, 1997-03)			
Poverty (% of population below national poverty line)	39
Urban population (% of total population)	21	40	30
Life expectancy at birth (years)	55	69	58
Infant mortality (per 1,000 live births)	87	32	82
Child malnutrition (% of children under 5)	40	15	44
Access to an improved water source (% of population)	37	76	75
Illiteracy (% of population age 15+)	34	10	39
Gross primary enrollment (% of school-age population)	115	111	92
Male	123	112	99
Female	106	111	85

Development diamond*

Life expectancy

GNI per capita

Gross primary enrollment

Access to improved water source

Lao PDR

Low-income group

KEY ECONOMIC RATIOS and LONG-TERM TRENDS	1983	1993	2002	2003	
GDP (US\$ billions)	..	1.3	1.8	2.0	
Gross domestic investment/GDP	
Exports of goods and services/GDP	..	21.5	
Gross domestic savings/GDP	
Gross national savings/GDP	
Current account balance/GDP	..	-7.8	
Interest payments/GDP	..	0.3	0.6	0.6	
Total debt/GDP	..	149.5	145.7	139.8	
Total debt service/exports	..	8.4	
Present value of debt/GDP	78.2	..	
Present value of debt/exports	
(average annual growth)	1983-93	1993-03	2002	2003	2003-07
GDP	4.8	6.1	5.0	5.0	5.0
GDP per capita	2.0	3.6	2.6	2.6	2.6
Exports of goods and services

Economic ratios*

Trade

Domestic savings

Investment

Indebtedness

Lao PDR

Low-income group

Source: World Bank, Economic Indicators of Development, 2004

Fighting poverty. In April, 2002, the Government of the Lao PDR finalized an Interim-Poverty Reduction Strategy. Using this and the five-year National Socio-economic Development Plan for 2001-05, the Government adopted a consultative process to prepare the National Poverty Eradication Program (NPEP). The NPEP was presented to the donors' Roundtable Meeting in September 2003, discussed by the National Assembly in October 2003, and subsequently upgraded in early 2004 to the National Growth and Poverty Eradication Strategy (NGPES). It articulates Lao's development framework for poverty reduction, specifies the targets and goals that the country values and indicates the policy reform and public expenditure programs that will be needed to achieve those goals.

ECONOMIC MONITOR – APRIL 2005– Covers the last six months. The Lao PDR Economic Monitor (the Monitor) is issued in Lao and in English, twice a year (Spring and Autumn) by the World Bank in Lao PDR. It reports on recent economic performance (Part I), progress in the implementation of the Government's policy reform agenda (Part II), and donor activities in the relevant reform areas (Part III). This issue of the Monitor was prepared by Somneuk Davading (Economist) & Francisco Quintano (intern) and Kazi M. Matin (Lead Economist, South East Asia). We would like to thank Renuka Vongviriyatham for their inputs and to Khun Ruangrong Thongampai for formatting the Monitor. We are also grateful to the Government and the donors for providing information and other inputs, as well as for sharing their views with the team. Our thanks also go to the staff in Bank's resident mission who provided support to the Monitor.

THE WORLD BANK TEAM APPRECIATES FEEDBACK ON THE STRUCTURE AND CONTENT OF THE MONITOR.

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ACRONYMS AND ABBREVIATIONS

ADB	Asian Development Bank	MOIC	Ministry of Information and Culture
AFTA	ASEAN Free Trade Area	MOFA	Ministry of Foreign Affairs
ASEAN	Association of Southeast Asian Nations	MOJ	Ministry of Justice
APB	Agriculture Promotion Bank	MOH	Ministry of Health
BCEL	Banque Pour Le Commerce Extérieur Lao	MOUR	Memoranda of Understanding
BOL	Bank of Lao PDR	NA	National Assembly
BOP	Balance of Payment	NPL	Non-Performing Loan
BPKP	Bolisat Phattana Khet Phoudoi	NPV	Net Present Value
BPO	Business Promotion Office	PM	Prime Minister
CEFT	Common Effective Preferential Tariff	NSC	National Statistical Center
CIC	Committee for Investment and	PEM	Public Expenditure Management
COCI	Cooperation	PER	Public Expenditure Review
CPC	Committee of Culture and Information	PIP	Public Investment Plans
DDFI	Committee for Planning and Cooperation	PMO	Prime Minister's Office
DOL	Department of Domestic and Foreign	PPIAF	Public Private Infrastructure Advisory Facility
	Investment Management	PRF	Poverty Reduction Fund
DONLUPAD	Department of Land Use Planning and	PRGF	Poverty Reduction and Growth Facility
	Administration	RMFC	Rural Micro Finance Committee
CPI	Consumer Price Index	SAMD	State Assets Management Department
EAP	East Asia & Pacific	SCB	State-owned Commercial Bank
ECC	External NPL Collection Committee	SIDA	Swedish International Development
EDL	Electricité du Lao		Association
EU	European Union	SOE	State-Owned Enterprise
FDI	Foreign Direct Investment	STEA	Science, Technology and Environment
FINNIDA	Finland International Development		Agency
	Association	TOR	Terms of Reference
FMAC	Financial Management Adjustment Credit	UNDP	United Nations Development Programme
FMCB	Financial Management Capacity Building	WASA	Water and Sanitation Authority
	Credit	WB	World Bank
FRP	Financial Recovery Plan	WTO	World Trade Organization
FY	Fiscal Year		
GDP	Gross Domestic Product		
GOL	The Government of Lao PDR		
GTZ	German Agency for Technical Cooperation		
HIPC	Highly Indebted Poor Country		
IMF	International Monetary Fund		
JICA	Japan International Cooperation Agency		
LDB	Lao Development Bank		
LMB	Lao Mai Bank		
LNCCI	Lao National Chamber of Commerce and		
	Industry		
LTA	Lao Tourism Authority		
LTC	Lao Telecom Company		
LXB	Lane Xang Bank		
MAF	Ministry of Agriculture and Forestry		
MCTPC	Ministry of Communication, Transport,		
	Post and Construction		
MDG	Millennium Development Goals		
MIH	Ministry of Industry and Handicraft		
MOAF	Ministry of Agriculture and Forestry		
MOC	Ministry of Commerce		
MOE	Ministry of Education		
MOF	Ministry of Finance		

INTRODUCTION

In 2004, economic performance improved further: real GDP grew by a little over 6 percent and is expected to strengthen to 7 percent on the back of rising foreign investment inflows to mining and hydro-power as well as of growing mineral exports. Agriculture, manufacturing and services all did better last year. Average inflation was slightly more than 10 percent in 2004 and is projected to be in single digits in 2005.

Domestically, reforms across various areas continued during the period under review, even if at a somewhat uneven pace. There was implementation of SOE restructuring, improvements in private investment environment and trade, strengthening of public expenditure management and revenue mobilization.

In addition, implementation of the National Growth and Poverty-Eradication Strategy (NGPES) gained some momentum since October, having stalled due to the unclear separation of responsibilities between Ministry of Foreign Affairs (MOFA) and Committee on Planning & Investment (CPI). The Government completed a workshop in October, with the participation from sector ministries and provinces, to discuss methodology and process for costing the proposed public spending programs in the Strategy. The next steps are to complete an initial costing, compare the resulting resource-needs for achieving the NGPES-goals with the current size of available financing, discuss with donors the availability of additional resources and assess the budgetary resources, and finally prioritize public spending interventions and the implied changes in sector allocations. The resulting prioritized medium-term public expenditure program will be an input into the next National Socioeconomic Development Plan (NSDP, 2006-10), the successor to the NGPES.¹

PART I – RECENT ECONOMIC DEVELOPMENTS

1.1 THE MACROECONOMIC SITUATION

Growth will continue to be buoyant. Real GDP has continued to grow robustly in 2004 and 2005. Agriculture grew by 3 percent but industry grew by more than 11 percent, in part due to higher growth in the mining sector. Continued export demand from the region and mineral exports to the world have been driving this growth, supported in no small measure by the planned foreign investments inflow into hydro-power and mining.

BACKGROUND

In the 1990s, Lao PDR grew at an annual average rate of 6.3 percent, and the incidence of poverty fell from 45 percent to 39 percent of the population in 1997-98 and to 29 percent in 2002-03. The crisis years of 1998 and 1999 saw inflation climb to an annual average of 110 percent and growth fall to 4 percent, but the resolution of the regional crisis and Lao's own policies stabilized the economy and resumed growth of around 6 percent.

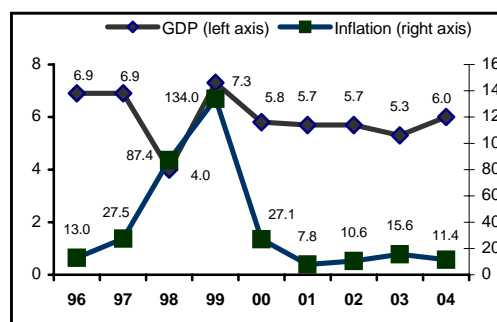
The adoption of a stabilization program since 2000 and the implementation of a phased program of reforms since 2001 – in public expenditure management, banking, state-enterprises, forestry, trade and private sector has contributed to this improvement. During the 2000-03 period, inflation has averaged 15 percent and GDP growth averaged around 5.6 percent annually.

The approval of Nam Theun II hydro-power project (see Box 1 for details) by the World Bank Board on March 31, 2005 and by the Asian Development Bank Board on April 4, 2005 means that various financing partners have committed a total of US\$ 1,450 million to Lao PDR to finance US\$1,250 million of project cost and US\$200 million of contingency. This investment is expected to occur between now and 2009. The resulting annual inflow is very large relative to the size of the Lao PDR economy, and will have significant growth effects during that period, even though most of this will comprise of imports.

¹ The Government announced, at the September donors' Roundtable Meeting (RTM), that it will merge the NGPES with the next NESDB, and have a single process and document for the Government's growth and poverty-reduction strategy.

Macroeconomic conditions have remained stable. Higher oil prices have raised Lao's import bill by more than 3 percent of GDP and increased domestic petroleum prices. But inflation has continued to fall in 2004 and 2005. Average inflation fell from 15.6 percent in 2003 to 11.4 percent in 2004, while end-period inflation rate fell to 5.5 percent in June 2005. The Kip also traded within a relatively narrow band. External reserves have remained at a comfortable level of 3 months of imports. Nominal interest rates have come down though at a slower rate than inflation; hence real interest rates remain quite high.

Figure 1. GDP Growth (%) and CPI (%)



Source: Lao authorities and WB staff estimates.
* CPI 2004 is an average of the first nine months only.

Nevertheless, fiscal position remains fragile. There are significant pressures for increasing the wage bill rapidly but revenue collection rate as of June 2005 is growing at a slower rate than the target set in the revised-budget for 2004/05. The weak financial situation of state-owned commercial banks (SCBs) is another fiscal vulnerability. Public external debt also remains high. Thus managing these pressures prudently will be key to maintaining the macroeconomic stability that Lao PDR is enjoying at present.

Revenue performance has improved slightly this year. After falling sharply in 2002/03, the share of total government revenue in GDP rose modestly from 11% in 2002/03 to 11.3% in 2003/04. The actual increase was larger for tax-revenues excluding timber royalties, rising from 8.1% to 8.9%, due to better collection effort from the provinces. In 2004/05 the favorable trend is continuing – total revenue collections has been rising in the first half of the year, but only at around half the pace that was set as target in the revised budget approved by the National Assembly. The delay in implementing the new Tax Law and slow progress in tax and customs administration reforms has meant that revenue performance will improve relative to last year but will fall short of revised-budget target. Clearly a significantly more vigorous Government collection effort will be needed – especially by the surplus provinces -- if revenue performance is to reach even 11.3% of GDP (still less than 11.6% set in revised budget).

Wage pressures appear to be rising further. The Government has been under considerable pressure to raise wages given their relatively low levels. However, actual increases in the wage-bill, in excess of the rise in wages & allowances, suggest that there is also pressure to increase employment, mainly from the provinces. This pressure in the face of revenue-collection shortfall relative to the revised-budget target is problematic if macroeconomic stability is to be sustained.

There is also evidence that arrears are rising again. This means that not all these pressures have yet manifested themselves in the actual deficit. The accumulated arrears will have to be paid off and financed through either additional revenue or compressed public spending in subsequent years. In the past there has been anecdotal evidence suggesting that provinces had contracted for projects but had not paid when the work was done; the result was non-performing loans at SCBs because private contractors that had borrowed for those contracts had not repaid the banks.

Consensus on the fragile fiscal situation is needed at all levels of Government. Actions have to be taken at both the provincial and the national level to make the fiscal situation Sustainable, and equitable. Macroeconomic stability must be maintained if growth and poverty reduction is to be sustained. For this purpose, surplus provinces have to understand the urgency of improved revenue collection and transfer to the national treasury. And all provinces must understand that new hires have to be undertaken very judiciously since they impose a recurring fiscal cost. All additions to aggregate public employment have to be decided jointly by all levels of

Government to ensure their fiscal prudence overall; then that prudent increase in public employment can be distributed across provinces based on relative need.

1.2 IMPLEMENTATION OF NGPES

The Committee for Planning and Investment (CPI) assumes the responsibility for coordinating the implementation of the National Growth and Poverty Eradication Strategy (NGPES) with the four main sectors and local authorities, by "*giving detailed advice and recommendations to the sectors for a gradual and concrete implementation*" (Prime Minister Decree no. 157, of 6 October 2004, on the Promulgation and the Implementation of the Socio-Economic Development and the State Budget Plans, FY 2004-2005). A key part of the implementation is (a) implementing reforms in NGPES, (b) costing and prioritizing all public expenditure interventions needed to achieve the NGPES goals, resulting in a medium-term expenditure (capital & recurrent) program that is agreed by Government and donors and (c) identify priority 'eligible public expenditure programs' within each of the four sectors that will implement more transparent reporting and more accurate accounting of such spending. This section is discussing only (b) since (a) and (c) are addressed in the rest of the Monitor on a semi-annual basis.

SIDA, WHO, UNDP and the World Bank are funding technical advisors to assist the line ministries in the costing and prioritization process. UNDP and the Bank are jointly supporting the CPI and the Ministry of Finance in coordinating and guiding the process, as well as supporting CPI in hosting the consultative workshops. Other donors are commenting on and participating in the substance and the process.

The Government is also formulating the next five-year national socio-economic development plan (2006-10) and expects to conduct consultations with its citizens and also donors once an initial draft is completed. The Government intends to incorporate the goals, reforms and targeted programs of the existing NGPES -- as well as the prioritized medium-term expenditure program that will result from the above process -- into the next five-year plan, so that the socio-economic development plan (2006-10) is also the *successor NGPES* of Lao PDR.

The CPI has been guiding the four key line ministries engaged in the NGPES (i.e. Ministry of Health, Ministry of Education, Ministry of Construction, Transport, Post and Communication, Ministry of Agriculture and Forestry) in a process of costing and prioritizing the sectors' public expenditure interventions/programs that will complement the NGPES policy reforms in order to achieve the medium-term goals of the NGPES. The Ministry of Finance has also been participating in this process. The donors and international NGOs have also been participating in these discussions and workshops, held for this purpose. The resulting prioritized and costed medium-term public expenditure programs (covering both recurrent & capital spending) in each of the four sectors, once agreed, will then be made an integral part of the five-year plan.

This process was initiated in October 2004, delayed by the internal re-organization of responsibilities for the NGPES that was underway in the first half of 2004. The aim is to link the sector medium-term expenditure plans -- developed through the above process of dialogue and discussion and consultation -- with the preparation of the annual national budget. This costing and prioritization process is also an integral part of the process of formulating the sector priority programs and their integration into the next Five-Year National Socio Economic Development Plan 2005/06-2009/10 (NSEDPlan); under the latter, NERI is preparing a five-year investment plan for the economy, including these four priority NGPES sectors and MOF a corresponding recurrent expenditure plan. The resulting sector expenditure (recurring & capital) plans will be the country's Medium Term Expenditure Framework (MTEF).

The first NGPES workshop of October 2004 (the proceedings including all documents presented are at World Bank website for Lao PDR) discussed the process of costing and prioritization, including

the methodology and type of data needed for a first cut of costs and the process of iteration that will follow in order to relate the total sector cost with the sector allocations (from budget & donors) and with the sector goals in NGPES and at arrive at a prioritized set of planned expenditure interventions. Three "NGPES workshops" for key government officials were expected to complete the process of costing and prioritization and the October workshop provided political endorsement of the subsequent work process.

A first-cut costing report was completed in May 2005 by the three Ministries of Health, Education, and Transport-Communications; the Ministry of Agriculture draft was completed later. This has been read by all ministries, including the CPI and the MOF, and will be discussed in detail at the next workshop.

The on-going costing of the sector programs takes an iterative approach with line ministries preparing preliminary costing of priority programs based on simple unit costing, whilst the Ministry of Finance provides an indicative sector budget envelop based on historical numbers and what is known about next budget and over the medium-term. With support from the Public Expenditure Management Strengthening Program (PEMSP) it is envisioned that Government will move towards a coherent, comprehensive multi-year expenditure plan which will also integrate external financing. But until then, once the likely budget envelop is identified, the residual external funding that is needed will also be known.

This external financing requirement will then be discussed with donors, to assess what is feasible, even with some growth in historical figures, and scaled down if the requirement cannot be met by the donors. Several iterations will thus be needed after the first costing plan, in order to arrive at a realistic, prioritized medium-term expenditure (recurrent & capital) program. The final program – once agreed by CPI & MOF and the leadership -- will be made part of the five-year plan, but it will have had the benefit of a bottom-up, consultative and top-down process.

The next NGPES-implementation workshop, titled “From Costing to Prioritization and Sequencing” will discuss these costing reports in the context of the NGPES sector goals, the sector strategy and the availability of resources. It is expected that key government institutions, such as Lao Women's Union, Department of Public Administration and the Science Technology and Environment Agency will actively participate and provide advice on cross sectoral prioritization criteria, as well as the World Bank sector staff and the five participating ministries in addition to CPI.

The final NGPES-implementation workshop scheduled will wrap up the results of the eleven months of costing and prioritization work of key sector ministries together with CPI & MOF and hopefully will result in a MTEF on which most ministries will have agreed. It will then generate the program based on known existing resources and a supplementary program that can be financed if donors are able to increase their support.

The costing and prioritization process provides an opportunity for continued consultation on the NGPES public expenditure policy, particularly within the Government ministries and agencies. It is already evident that the process has revitalized consultation on the NGPES implementation among the core members of the NGPES working group and strengthened cooperation between CPI and the MOF by virtue of the joint guidance that is needed by the four line ministries.

Consultation among the central and local levels of government, particularly the poorest districts, are also integral to this process. Participation of selected provinces and districts in the NGPES workshops, as well as visits to selected poorest districts led by CPI, a team of representatives from line ministries have had the opportunity to further discuss and evaluate the development needs at the local level and how sector programs listed in the NGPES need to take that into account.

PART II – STRUCTURAL REFORMS

2.1 PUBLIC EXPENDITURE POLICY AND MANAGEMENT

BACKGROUND

Since 2001, the government of Lao PDR revived its public expenditure reform, by reassessing its expenditure policies and its public expenditure management processes. The last PER, the CFAA and the CPAR were completed in 2002 & 2003 thereby raising issues and spurring actions, albeit slowly. These actions have made the legal framework for procurement a sound one, and other actions have improved transparency and accountability even if there is still a long way to go. Public expenditure policy has also been improving, though with stagnating share of revenues in GDP and accumulation of arrears, the spending choices remain constrained. Nevertheless, there have been increases in expenditure on education and health in recent years and further efforts are underway to meet the country's poverty reduction objectives. Managing wage increases, and restraining growth in public employment to ensure sustainable growth in total wage-bill is a pressing need. Phased payment of arrears, better balance between recurrent and capital expenditure and more efficient social sector spending remain important. Thus more effective, accountable and transparent public expenditure management processes and improved public expenditure policies will be key in all future efforts of the Government of Lao PDR.

Public expenditure policy. In Lao PDR, total expenditures have been relatively flat as a share of GDP. In real per capita terms spending on service delivery in health and education fall short of the levels seen in the mid-1990's; in 2004 health and education expenditures were 1 percent and 1.4 percent of GDP respectively, though unit cost of delivering services is higher due to demographic and geographic (scattered population) characteristics of the country. Nevertheless, the share of total spending going to education and health sectors have increased from 11 percent in FY2001 to 16 percent in the FY2004 (from 13 percent to 18 percent when debt service is excluded) and share of recurrent spending in total domestically-financed public spending have gone up noticeably in the last 3 years, in part due to increases in the wage bill.

In order to reduce the imbalance between capital and current expenditures, the Lao government increased current expenditures by 2 percent in 2003/04 as share of the total spending and by 0.6 percent as share of GDP. The share of salaries and wages went up slightly by 1 percent, from 17 percent to 18 percent. The capital spending dropped by 5 percent, from 59 percent to 54 percent in the same period. As percentage of GDP it declined from 11.2 percent to 10.6 percent.

According to budget publications in May 2004, in sectoral terms the share of spending going to agriculture in 2002/03 was more than 11 percent of total spending, higher than before, while health and education received 15.7 percent (see Table 4).

The plan was to reduce agriculture's share in total spending in 2003/04 to 8 percent and raise education by 1 percentage point; infrastructure and health were to receive similar shares. This implied that these four sectors together received a lower share than in 2002/03. Early indications are that actual spending confirms that plan. But we will not know for sure until the publication of the budget out-turn in April 2005.

Table 2. Government expenditures

	2002/03	2003/04
		est.
<i>(billion Kip)</i>		
Total expenditures	4,029	4,864
Current Expenditure	1,659	2,081
O.W. Wages & Salaries	671	871
Capital Expenditures	2,370	2,633
O.W. Domestically-Financed	1,026	551
Unallocated		150
<i>(percent of total budget)</i>		
Total expenditures	100	100
Current Expenditure	41	43
O.W. Wages & Salaries	17	18
Capital Expenditures	59	54
O.W. Domestically-Financed	25	11

	2002/03	2003/04
		<i>(percent of GDP)</i>
Total expenditures	19.1	19.6
Current Expenditure	7.8	8.4
O.W. Wages & Salaries	3.2	3.5
Capital Expenditures	11.2	10.6
O.W. Domestically-Financed	4.9	2.2

Source: Lao authorities and IMF

Table 3 Government expenditure for four key factors

	act.	plan
	2002/03	2003/04
Overall Public Spending	100.0	100.0
Central	55.3	67.3
Provincial	44.7	32.7
Agriculture	11.5	7.9
Central	16.7	39.9
Provincial	83.3	60.1
Recurrent	4.5	5.7
Capital	94.6	93.1
Infrastructure (MCTPC)	22.3	22.6
Central	50.6	62.5
Provincial	49.4	37.5
Recurrent	0.7	0.6
Capital	98.2	98.4
Education	9.9	10.5
Central	44.0	50.8
Provincial	56.0	49.2
Recurrent	28.5	26.4
Capital	61.0	64.9
Health	5.8	5.2
Central	32.0	44.7
Provincial	68.0	55.3
Recurrent	17.8	18.4
Capital	79.6	79.2
Total Four Sectors	49.6	46.3

Source: Official Gazette 2004, MoF

Public Expenditure Management

Building on the actions taken earlier by the Government as well as the technical assistance and advice provided by the World Bank, the IMF, the ADB, the UNDP and other bilateral donors the Government adopted a comprehensive, five-year **Public Expenditure Management Strengthening Program (PEMSP)** in early 2005. This Program focuses on the strengthening of management systems and the capacity of the Ministry of Finance and Provincial Finance Departments, through reform measures implemented annually – all of which are fully consistent with the Government's "Policy Paper on Governance" and its "National Growth & Poverty Eradication Strategy"². This Program has following five components:

- A. *Fiscal Planning and Budget Preparation* to ensure that expenditure planning and budgeting systems effectively allocate public resources according to the Government's development and poverty reduction policy objectives.
- B. *Budget Execution, Accounting and Financial Reporting* to ensure that public resources are applied efficiently, transparently and accountably in support of the Government's development and poverty reduction policy objectives.
- C. *Local Government Financial Management* to ensure that provincial and district administrations allocate and apply public resources efficiently, transparently and accountably in support of the Government's development and poverty reduction policy objectives and local needs.
- D. *Financial Legislation and Regulatory Framework* to put in place a coherent regulatory framework that supports policy consistency, efficiency, transparency and accountability in public expenditure management and progressive adoption of appropriate international standards.
- E. *Capacity Building* to ensure that relevant officials of the Government of Lao PDR have the technical skills needed to discharge their assigned expenditure management functions through targeted on-the-job & formal training resulting in a cadre of accredited financial management personnel.

² "Priority Areas for Governance Reform: A Policy Paper of the Government of Lao PDR on Governance Issues" A Policy Paper of the Government of Lao PDR on Governance Issues, Roundtable Process, Vientiane, March 2003

For PEMSP implementation, the Ministry of Finance has established an internal "Program Steering Committee", comprising of representatives of the relevant Ministry of Finance departments and chaired by the Vice-Minister. The Program Steering Committee will review and approve departments' annual work plans, which lay out the steps to be taken to implement program components, and department's progress reports. A "Program Coordination Committee" chaired by the Ministry of Finance with participation of contributing partners will meet twice-yearly to: review and update the program in line with progress in program implementation and the Government's policy directives; and program external support, including training and technical assistance inputs, required for program implementation. A Program Coordinator has also been appointed to support the "Program Steering Committee" and "Program Coordination Committee" for day to day administration of the program.

The external partners are expected to support PEMSP implementation as its objectives are highly relevant to all donor programs in Lao PDR. The World Bank, the IMF, the ADB, the UNDP, the EIB, the EU and SIDA are already supporting this process directly, and others are planning to do so as well. The Government expects to use available grant-financing for technical assistance and staff-training, as well as the upgrading of financial management information system and other relevant facilities, including Ministry of Finance training institutions.

There will be semi-annual monitoring reports by MOF that will monitor progress against each component's performance indicators that will be the basis for semi-annual reviews done together with PEMSP partners. There will also be a larger more detailed *mid-term review of PEMSP with external partners*, scheduled currently in FY2007, in order to take stock of progress until then and to update implementation plan for PEMSP to ensure that agreed targets for 2009 are met.

In addition to the development and adoption of this comprehensive multi-year reform program, Lao PDR continued to take actions: the Government updated the registers of accounts payable as well as the Government bank accounts as of the end of FY2003-04, as preliminary steps towards putting in place routine cash plans; following up on the excellent improvements in procurement framework done in 2003 & early 2004, the MOF approved the charter of the Procurement Monitoring Office and developed the draft procurement manual; the budget continued to be published and further steps were taken to review the treasury rules and procedures.

2.2 REFORM OF STATE-OWNED ENTERPRISES

BACKGROUND

The objective of the government's SOE reforms is to enhance transparency, reduce waste and increase efficiency in order to promote their commercial viability and reduce their budgetary burden. Reforms implemented in the early 1990s reduced the SOE sector by closing down, leasing, merging and selling a large number of SOEs. The number of SOEs today are fewer, but more importantly, they play a significantly smaller role in Lao's economy in terms of its share in GDP and in its share in total employment. Nevertheless, several large SOEs have been generating a large share of the non-performing loans (NPLs) in the state-owned banking system, which risks the banking sector and ultimately needs to be funded by Government revenue.

The Government's SOE reform program, this round initiated in 2001, has three thrusts: (a) improving transparency and governance of state enterprise sector (b) restructuring larger SOEs which are losing money and accumulating debt to banks, and (c) rationalizing the regulatory and pricing environment for infrastructure SOEs, through tariff policy reform. Progress over the last three years has been uneven. Good progress was made in late 2003 and early 2004 in preparing detailed time-bound restructuring plans for 4 large SOEs (2 in infrastructure) to restore their commercial viability and in monitoring the annual performance of the SOE sector. Subsequent progress in implementing these plans has been slow. The Government now needs to move on implementing restructuring actions for the 4 large SOEs above, on developing restructuring plans and doing actual restructuring in the other 5 large SOEs and in taking actions on more than 30 smaller SOEs identified as losing money in recent performance assessments.

SOE Reform Actions in 2004 & early 2005

These actions have covered increased transparency of information, actual restructuring of 4 large SOEs, development of detailed restructuring action plans and actions for another 5 selected SOEs, and annual monitoring of performance of all SOEs. There has been progress in all areas, albeit very gradually, with responsibility for restructuring shifted more to SOEs and to relevant line ministries with BPO charged mainly with monitoring. But there is some good news: SOE losses have come down, the share of commercial bank lending to SOEs has fallen sharply and the transparency of information on SOEs have increased in several ways, including more open and public discussion of SOE reform issues among stakeholders in Lao PDR.

Ongoing Restructuring of 4 large SOEs. The process of restructuring has taken a long time, especially preparation of detailed restructuring plans and a consensus on the restructuring actions needed for restoring commercial viability. Full consensus on actions was obtained only for the 4 large SOEs cited below in April 2004. Between May 2004 and March 2005, the Business Promotion Office (BPO in Prime Minister's office) and the Minister in charge of BPO has been coordinating the implementation of detailed time-bound SOE restructuring plans, developed with the assistance of external consultants and supported by the World Bank. Despite slower pace of implementation than originally planned, there has been progress in terms of the actions in addition to the establishment of 'Restructuring Committees for each of 4 SOEs and details are cited below.

Lao PDR Airlines. Lao Airline's losses jumped in 2003, with the lease of an Airbus 320. The restructuring plan recommended the termination of the Airbus lease and the conversion of Lao Airlines into a joint-venture with a foreign airline, with GOL holding less than majority shares to encourage foreign partners. The Government did take measures aimed at stemming the losses: the Airbus was grounded in November 2004 and its lease was terminated in February 2005; five loss-making domestic routes were stopped; the frequency of two other low-load routes were lowered; and the staff-strength was reduced. Monthly operating losses fell in November and then again in February.

The joint venture negotiation with Vietnam Airlines has been ongoing since October 2004, but significant differences in the positions of the two sides have prevented any agreements. The MCTPC and BPO have indicated that they will hire a technical advisor and expand search for a joint venture partner – though the high oil-price environment and consequent stress in airline industry is not conducive for this search.

Bolisat Pattana Khet Phoudoi (BPKP). BPKP's core businesses (wood processing and construction) have potential for commercial viability. The restructuring plan seeks financial restructuring (through debt rescheduling and asset revaluation), and sale or transfer of *non-core* businesses and their assets. Implementation started in May 2004; since then branch offices have been closed; a non-core but viable business (i.e., a tourism centre) was separated from BPKP and numerous non-core and non-viable activities were sold or transferred to provinces (e.g. three hotels and two guesthouses) and to the Ministry of Defence (i.e., a saw mill and a shoe factory). BPKP management also re-valued its remaining assets, now estimated at around US \$32 million, with liabilities still largely exceeding assets. Some non-core assets have been leased and ought to be contributing to the bottom-line but the results will not be known until the international standard audits are completed.

Nam Papa Lao (renamed Nam Papa Nakhoneluang Vientiane). This water supply company for Vientiane has taken steps to reduce its high operating costs (resulting from inefficient procurement of raw materials, large water losses, and interest cost on rising debt) and to raise its low tariffs (tariffs that were lower in the city than in rural areas). In 2004, debt-equity conversions and increases in tariffs improved the bottom line. But we do not know the size of reduction in operational costs. Further reductions in costs are expected in 2005, through water-loss reduction and improvement in receivables-collection by disconnecting delinquents. Procurement for an international standard audit performance for 2004 is expected to be completed in September 2005.

Pharmaceutical Factory Number 3. Through new machinery and cost-cutting, losses have been reduced to less than 10 percent of total sales. The Japan Pharmaceutical Manufacturers Association is also providing technical assistance to improve its production-management, as well as its equipment, given its relatively captive market. However, not until the international standard

audits are completed will the impact of all these actions will be know with any precision. Procurement for this international standard audits is underway and expected to be completed by September 2005.

Development of Restructuring Plans for another 5 SOEs.

Tariff Policies for Infrastructure SOEs

Actual tariffs and the policies guiding tariff change infrastructure have come a long way. Tariffs in respect of electricity, telecommunications, water and aviation are closer to cost-recovery levels than they have ever been. Also, guiding principles for tariff changes and explicit Government commitment to tariffs being based on full cost-recovery are now enshrined in PM decisions that were published. The specific background and recent developments in respect of each of these areas are given below:

BACKGROUND

Most of the infrastructure services in Lao PDR -- electricity, water, telecommunications and aviation -- are provided by SOEs, though increasingly, more private providers are entering into these services. The Government, cognizant of the need to reduce budgetary subsidies to these services and to tap into the private financing of investments, have been moving to more appropriate tariffs and prices for such services. There has been a good deal of Government action in this respect over the last three years. These actions relate to: 1) actual changes in tariffs and in tariff structures and 2) announcement of guiding principles for setting of tariffs and for changes in those tariffs. In particular, tariffs were raised towards greater cost-recovery and policies and principles were announced that would guide future tariffs and tariff changes in respect of water, telecommunications, power and aviation, through Prime Minister's Notices.

Water Tariff

Following the water tariff increases from 195 Kip/m³ in 2000 to 650 Kip/m³ in July 2002, water tariffs for Vientiane Capital were raised for the second time between July and December 2004. Especially in respect of two categories of users that were subsidized. Water tariffs for households & government offices were raised by 27 percent on average and for commercial & industrial users by 32 percent on average – those for foreign embassies were left unchanged. This has helped to improve the commercial viability of urban water SOEs and reduced the extent of subsidy received by users in Vientiane.

Table 4. Water tariff changes in Vientiane, 2004

Water users	Consumption Vol.(m³)	Before Mar-04	Mar-Jun 2004	Jul-Dec 2004	Percent change
			(Kip/m ³)		(%)
Group I. Households, government offices	0 - 5	219	285	350	23
	6 - 30	292	412	526	28
	> 30	<u>336</u>	<u>546</u>	<u>706</u>	<u>29</u>
	<i>Average</i>	282	414	527	27
Group II. Commercial & industrial	0 - 10	691	899	1,210	35
	11 - 50	869	1,303	1,720	32
	>50	<u>953</u>	<u>1,811</u>	<u>2,364</u>	<u>31</u>
	<i>Average</i>	838	1,338	1,765	32
Group III. Embassies, foreign residential	0 - 10	6,184	5,260	5,260	0
	11 - 50	7,668	5,620	5,620	0
	> 50	<u>7,668</u>	<u>6,180</u>	<u>6,180</u>	<u>0</u>
	<i>Average</i>	7,173	5,687	5,687	0

Source: Lao authorities (BPO, WASA & NAM PAPA Vientiane)

Electricity Tariff

The Government has been raising electricity tariffs at a rate of 2.3 percent per month since May 2002 for 26 months; these increases were stopped in July 2004 – 10 months earlier than was committed by the Government -- on the grounds that there was a significant and sufficient improvement in the financial condition of Electricity du Laos (EdL). The table below shows the financial improvement that resulted not only from tariff-increases but also from other financial restructuring measures that were being undertaken since 2001.

Table 5: Changes in Financial Ratios of Electricity du Laos

	2000	2001	2002	2003	2004 est.
Self Financing Ratio	-43%	-17%	55%	37%	40%
Debt Service Coverage Ratio	0.90	1.5	0.4	2.4	3.1
Return on Capital Employed	5.0%	5.2%	1.6%	1.0%	5.5%
Operating Ratio	58%	55%	80%	86%	81%

Nevertheless, as of 2004 EdL remains dependant on a subsidy of *17 percent* of its total revenue-required for full cost recovery. In other words, tariffs must rise or costs of producing and transmitting electricity must fall -- or some combination of tariff increase and cost reduction have to take place if EdL is to reach full commercial and economic viability.

Households get subsidy. Tariffs as of 2004 imply that nearly 85 percent of residential customers of electricity receive varying degrees of subsidy, though only 22 percent of all residential customers can be viewed as low-income electricity-consumers, using less than 25 Kwh per month. This 22 percent of residential customers pay only 15 percent of the cost of producing & transmitting that electricity – the Government will have to decide whether these customers should get this size of subsidy, given all other uses of this money. The other 63 percent of residential customers, each using between 25 and 150 Kwh per month, pay around 35 percent of the cost of electricity.

The overall subsidy of 17% to EdL is being funded by the dividends from electricity export projects that could be used elsewhere. This subsidy is being enjoyed mainly by residential customers – including the 63 percent of such customers that use 25-150 Kwh per month and appear relatively better off. This money, used for subsidy, could be spent instead on education, health and rural infrastructure services for the rural poor in Lao PDR.

The Government is currently studying ways of (a) reducing EdL cost of producing & transmitting electricity (b) of raising average tariffs of EdL and (c) of raising more the tariffs for residential customers of EdL, especially those using 25-150 kwh per month – all with the objective of reducing the overall subsidy of 17% that EdL now receives.

Telecommunication Tariff

Background

The current capacity of the telecommunications sector in Lao PDR is relatively small - estimated to be 90,000 fixed lines and 141,000 cellular lines – with two-thirds of this capacity is in Vientiane. Transmission to Northern provinces is limited by mountainous geography. There are four authorized enterprises to provide fixed and mobile telecommunications in Lao PDR, with all four providing mobile phones but only three providing fixed lines. All of them have some government ownership. The enterprises are as follows:

- (i). Lao Telecommunications Co Ltd (LTC) providing fixed line, mobile and other services; (shareholding: GOL 51% Shinawatra 49%)
- (ii). Enterprise des Telecommunications Lao (ETL) providing fixed line, mobile and other services (GOL 100%)
- (iii). Lao Asia Telecom (LAT) providing fixed line, mobile and other services; (Ministry of Defense 100%)
- (iv). Millicom International Cellular SA (MLL) providing only mobile and other services

(v). (GOL 22% ; Millicom 78%)

The entry of Millicom, the large shareholding by Shin Corp, the operations of PlaNet and the prevalence of Voice over Internet Protocol (VoIP) operators show that private sector investment is available and that private investors are willing to invest in Lao PDR under the current policy regime. However, such investment is still primarily limited to activities in Vientiane and there is need to take stock of the situation to see how access to telecommunications services can be expanded across Lao PDR.

These tariffs were revised upwards in early 2004 (reported in last Monitor) whereby fixed line rentals and local fixed line call rates were both increased, even as international calling rates were lowered. The mobile rates reflect cost-recovery and thus are at competitive levels.

The telecommunication sector in Lao PDR thus remains relatively open with private entry and private operation, albeit as joint-ventures with some Government shareholding. Foreign investment is also coming into this sector for the provision of various services and the number of phone lines, especially cellular, continues to grow...Nevertheless, the fact that many areas of Lao PDR do not have phone or telecommunication service, means that further actions are necessary for more remote locations.

For earlier SOE reform measures taken in previous years please refer to the Annex – Box 2.

2.3 FINANCIAL SECTOR REFORM

BACKGROUND

The Lao PDR banking system is its financial sector, with insurance being the main non-bank part. The banking system is small in absolute terms, with total system assets of approximately US\$500 million, which is around 20% of Gross Domestic Product (GDP). In the first phase of reforms in the late 1990s, Lao PDR moved away from its mono-bank system, separating central banking from commercial banking and permitting joint-venture and foreign banks to operate in the country. In the mid-1990s, state-owned commercial banks (SCBs) were restructured, rehabilitated and recapitalized., but the SCBs accumulated significant non-performing loans since then, especially in respect of SOEs.

Thus restructuring those banks, and improving regulation and supervision to reduce flow NPLs and resolve stock NPLs have been part and parcel of banking reforms since 2001. Supporting micro-rural finance and opening up the banking system have also become key pieces of this round of banking reforms. The challenge is to get SCBs to run on more commercial principles, improving their lending decisions and enhancing their risk management practices. BCEL is the largest SCB. Two smaller SCBs were merged into a new SCB called the new *Lao Development Bank (LDB)*. Various changes in regulations were issued in 2001 and 2002 (see Box in the Annex). Today, the banking system comprises of three state-owned banks, including the policy bank, the Agriculture Promotion Bank (APB), three joint-venture banks, six branches of foreign banks, one representative office and several domestic private banks.

Beyond the priorities of stopping losses in SCBs, resolving NPLs in SCBs and restructuring their operations on commercial lines, key next steps include developing a holistic medium term financial sector blueprint with a ten-year vision, including delineation of the role of private sector in banking sector. Strengthening the legal framework and judicial capacity to enforce contracts on a fair and timely basis through a specialized commercial court is also being discussed, as are improved accounting standards and practices. Building capacity of staff in central and in commercial banks must also be part of continuing reforms.

Bank restructuring and reform seeks to increase overall transparency and information, restructure insolvent state-owned-commercial banks (SCBs), improve prudential regulations and supervision and ensure adequate flow of quality credit while ensuring sound health of the banking sector.

Transparency.

Annual international standard audits by independent auditors allow relevant authorities to monitor the financial situation of state-owned banks and the progress of restructuring program for the SCBs like BCEL and LDB. In October 2004, the 2003 independent IAS audits for BCEL and LDB were completed, and the compliance audits for Governance Agreements as well as 2004 IAS audits were initiated. The independent IAS audit for APB's 2002 and 2003 financial years and the portfolio review are underway and expected to be completed soon.

The Decree of the President on Commercial Banks has been submitted by the PM Office to the Standing Committee of the National Assembly for discussion and approval. The proposed amendments intend to ensure a level of playing field, reduced barriers to entry, and competition

for non-state commercial banks. In addition the BOL and MOF are also initiating work that would lead to the development of a medium-term Financial Sector Strategy and Action Plan, that would be subject to consultation with relevant stakeholders before it is submitted to the PM Office.

Restructuring of State-owned Commercial Banks (SCBs)

The two SCBs have been undergoing restructuring since 2001 with the support of World Bank, the IMF and the Asian Development Bank (ADB). The restructuring framework to (i) resolve NPLs (ii) reorient towards more commercial lending instead of directed lending and (iii) use international technical advisors and (iv) raise transparency of SCBs' operations through annual IAS audits, is being implemented, albeit unevenly and with limited impact on performance. In 2003 this framework was formalized through signed 'Governance agreements' with each SCB assisted by two international banking advisors; the latter's role was to strengthen SCB operations, improve credit review process, develop internal policies and procedures and provide necessary implementation assistance to reduce directed lending and enhance quality of commercial loans.

Asset qualities continue to deteriorate at a rate slower than in the past, but still too high to be acceptable. Recent audit of Governance Agreements show several non-compliances. Also advices of IBAs are, on several occasions, not being followed with harmful impact on asset quality. It appears that current governance arrangements under 100 percent Government ownership is not creating the incentives to reduce directed lending adequately and thus improve asset quality sufficiently. The Government, together with ADB, IMF and WB are taking stock of progress and alternative steps to re-invigorate the reform and restructuring strategy.

Prudential Regulations

In the first quarter of 2005, the draft amendment to the Decree Law on Commercial Banks has been submitted to the Standing Committees of the National Assembly, aiming to ensure level of playing field and lower barriers to entry and expansion of non-state owned banks. Further amendments to remove remaining legal and regulatory impediments to competition from non-state financial institutions are expected to be developed by BOL and MOF in consultation with key stakeholders during the rest of 2005 so that they can be submitted by BOL to the PM's office

The amendment to the Secured Transaction Law was endorsed by the National Assembly. The amendment helps strengthen credit enforcement regime. The type of security for movable assets is extended from the current three, to an unrestricted position, which would facilitate the financing of large scale projects. In the event of a default, the new amendment should enable banks to seize security without the court intervention (except in the case of dispute) and remove the need to have an agreed price before sale.

In mid-2004, BOL issued the revised regulation on loan classification and provisioning requirement, whose full implementation is expected in 2005. The revision seeks to ensure that commercial banks consistently review and grade loans, properly account for unpaid interest in profit and loss statement and adequately set aside provision expenses.

Rural and Micro-finance

The BOL has disseminated in three provinces the Rural and Microfinance policy and action plan that was developed by BOL in collaboration with provincial governors and approved by the Prime Minister's Office in early 2004. An appropriate legal instrument (BOL's instruction or Prime Minister's Decree) will be issued soon to establish a legal framework for effective implementation of the Rural and Microfinance policy and action plan and the implementation regulation will allow a diversity of microfinance institutions (MFI) both in form and ownership to be established in Lao PDR with full autonomy in their operations, especially MFIs ability to charge commercial interest rates. BOL has already informally approved some MFIs – not a wise step to take – and are expected to be formalized as soon as the legislation is issued.

For the reform measures taken in previous years please refer to the Annex – Box 3.

2.4 TRADE REFORM

BACKGROUND

Lao PDR has been integrating gradually into the world economy since 1989. The reform process accelerated after Lao PDR accession to the ASEAN and the joining of AFTA in July 1997. The highest current import tariff rate is 40 percent (compared to about 150 percent in 1995) and for most product groups is below 20 percent. The current tariff schedule has six tariff-rates: 5, 10, 15, 20, 30 and 40 percent, with un-weighted average MFN tariff of 11.3 percent. Non-tariff and quantitative import restrictions remain and in several sub-sectors are the primary binding restrictions. The country started to implement the AFTA Common Effective Preferential Tariff (CEPT) scheme in January 1998 and will complete the liberalization schedule by 2009 reducing its tariff on imports from ASEAN countries to 0-20 percent by 2005 and 0-5 percent by 2009; however, the legislative enactments for 2004 and 2005 for this purpose have been delayed. The Government has recently introduced one-stop services at customs border check-points to reduce bureaucratic procedures and provide better export and import services.

Increasing Openness.

1. **AFTA.** The reform process accelerated after the country joined ASEAN and AFTA in 1997 and started to implement the AFTA Common Effective Preferential Tariff (CEPT). Lao PDR expects to remove its licensing restrictions and reduce tariffs to 0-5 percent by 2008 on its imports from ASEAN countries. The highest current import tariff rate is 40 percent (150 percent in 1995) and for most product groups is below 20 percent. Lao PDR signed a bilateral trade accord with the US in 2003 and the Normal Trade Relations (NTR) status was granted in November 2004. Lao PDR has recently applied for accession to the WTO and has been working on the preparatory stage. Tariffs – both multilaterally and for ASEAN -- are now relatively low, but unfortunately licensing still covers a significant portion of imports and customs processes for clearing imports remain cumbersome and time-consuming.

Normal trade relations (NTR) with USA

In November 2004, the USA granted Lao PDR normal trade relations (NTR), bringing into effect the US Bilateral Trade Agreement (USBTA) with Lao PDR signed sometime ago. The significance of the BTA for future trade policy is that Lao exporters now have direct access to the US market, instead of being restricted by prohibitive US tariffs without the NTR. In the short-run, the Lao PDR industries that stand to benefit the most from increased market access are the garment and handicraft sub-sectors. Although the garment industry will now face very stiff competition from China and others from Asia in both European and the US markets, it also has an opportunity to expand the country's exports to the US. The improved access to the US market will help offset the adverse effects on the garment industry of increased competition from China in the European market following the ending of the Multi Fiber Agreement (MFA).

The USBTA is likely to stimulate new exports by attracting FDI from the US, though this impact has been very small that the USA is not currently among the top 10 countries by origin of FDI into Lao PDR. Opportunities to export to the USA are likely to attract investment not only from US investors, including the Lao community in the USA, but also from Lao domestic investors and from other foreign investors.

The BTA with the U.S.A. (see sub-section 4.4) includes major commitments by the Government of Lao PDR to liberalize trade in goods and services. These commitments come under three main headings that are dealt with in the remaining three parts of this sub-section: commitments to increase the transparency of the regulatory environment for imports and eliminate NTBs; granting of tariff concessions to exports from the USA; and commitments to open service sectors to competition from the USA. These commitments are closely related to the reforms that will be required for accession to the WTO.

Lao PDR has made major commitments under the BTA to raise the transparency of the regulatory framework for imports and to comply with the WTO norms on the implementation of such regulations.

If this provision was fully implemented, the few remaining examples of restrictive licensing of imports and exports would have to be removed. Thus restrictive licensing that is currently permitted for agricultural products, cement, steel, fuel—would have to go. The lists of controlled imports and exports are now available on the web site of the USTR and are therefore readily available to the public for the first time.

- Technical barriers to trade (TBT) must not be trade restrictive.
- Sanitary and Phyto-Sanitary (SPS) regulations must be based on scientific principles and must not exceed the minimum needed to protect human, animal or plant health.
- Customs valuations must be based on transactions values.
- All foreigners will have the right to participate in import and export trade, regardless of whether they have invested in Lao PDR or not.
- All laws and decrees will be made publicly available before they become effective.
- Administrative and judicial bodies will be set up to which appeals against arbitrary bureaucratic decisions can be made.
- Lao PDR will introduce and implement a very greatly strengthened regime for the protection and enforcement of IPR.
- Lao PDR has now, for the first time, listed the imports and exports subject to non-automatic licensing in terms of a detailed list specified by HS code. Formerly these lists contained extremely broad categories, for example 'agricultural products', 'cultural' products and so forth. Now they are specified down to 8 digit HS code items, such as "9504.20.10 billiard chalks", imports of which are subject to government surveillance.
- Lao PDR agreed that non-automatic import licensing will only be applied for balance of payments purposes and will be implemented in accordance with GATT principles. The need for balance of payments controls on imports is to be reviewed annually and Lao PDR has agreed that it will be gradually phased out. Nothing in this provision refers specifically to the licensing of trade with the USA; Lao PDR's commitment covers the licensing of trade with all countries.

Goods sector: Lao PDR will grant a wide range of phased tariff preferences to goods from the USA. The preferences are listed in Annex B of the BTA and cover 170 HS code items, of which 123 are agricultural products and 47 are industrial products. Most of the products are on Lao PDR's AFTA inclusion list. However, 21 agricultural products are on the Sensitive List (SL) and 8 agricultural products and 11 industrial products are on the Exclusion List (EL). Under the BTA, Lao PDR is committed to the limitations on its non-tariff barriers on a global basis—not just in its trade with the USA. Once it enters the WTO the other concessions will also become available to all WTO members as a result of the MFN principle.

Services Sector: Before the signing of the BTA, Lao PDR had made very little progress in opening up its service sectors to international competition. The BTA radically alters this situation as it stipulates that Lao PDR and the USA will grant national treatment to each other's service sector providers. This applies to *all* service sectors. In addition, Lao PDR will fully open the following service sectors to providers from the USA:

- Professional services (accounting, legal, architecture, tax consulting, auditing, bookkeeping)
- Computer services
- Business services
- Telecommunications
- Audio visual
- Construction and engineering
- Wholesale and retail distribution
- Insurance, banking and financial
- Health and medical
- Tourism and travel

This covers four types of service delivery i.e. delivery from territory of one party to that of the other; delivery in territory of either party to a service consumer of any other party; delivery by commercial presence in territory of the other party; delivery by natural persons in the territory of the other party. The BTA outlaws the following restrictions i.e. limits on the number of foreign suppliers; limits on the value of transactions by foreign suppliers; limits on the maximum

proportion that foreign equity investors may hold in the total equity of service providers; limits on the value of individual, or aggregate, foreign direct investment in service sectors.

In addition, Lao PDR will fully open the following service sectors to providers from the USA:

- Professional—legal, accounting, auditing, tax consulting, architectural, engineering.
- Computer and related services.
- Business—advertising, market research, management consulting.
- Audio-visual services.
- Construction and related engineering services.
- Distribution—wholesaling, retailing, franchising.
- Insurance, banking and financial services (defined broadly and in great detail).
- Health and medical care.
- Educational services.
- Tourism and travel.

In the long-run, however, these commitments are likely to be of major benefit to Lao PDR. Opening Lao service sectors to foreign competition will have major benefits for consumers and businesses that depend on access to efficient financial, accounting, marketing and other services in order to be internationally competitive

For the reform measures taken in previous years please refer to the Annex – Box 4.

2.5 PRIVATE SECTOR DEVELOPMENT

BACKGROUND

The Constitution of 1991 protects state, collective and private forms of ownership. During the 1990s an active program of legislation began to lay the foundation for the development of market based rules and institutions to support private sector development. The foreign investment legislation was passed in 1988 and a legal basis for land for use and transfer began to be established in 1992-93. Today all agricultural production and most of manufacturing production is in private hands; the industrial sector accounts for 5 percent of employment and state-enterprises cover only around one percent.

Nearly 97 percent of manufacturing units are small (less than 10 employees). Of the medium and large units, 35 per cent were privately owned by Lao citizens and 55 per cent were joint ventures with foreigners; the rest were owned by government (including provincial governments).

Foreign investments have been flowing into garments, wood processing, tourism, hydropower generation and more recently, mining. Between FY 2000/01 to FY 2001/02, foreign investment volume increased and approvals of investment increased tenfold (from US\$42m to US\$492m for the same period) and the actual went up by 23 percent (or from US\$75 m to US\$93m). In 2002/03, the approved FDI declined to US\$466m but the actual investment increased to US\$155m (or by 67 percent). The growth was largely due to mining, hydropower and service sectors. The main foreign investors are from Thailand, Malaysia, Singapore, Vietnam (ASEAN), China, Australia, South Korea, Taiwan, France, the Netherlands and United States.

In recent months, the Government of Lao PDR, especially the CPI, has taken a number of measures to promote both domestic and foreign private investments and improve the environment for doing business in the country more generally. Domestic and Foreign Investment Laws were revised in October 2004. The revisions to the investment laws have extended the investment term for foreign investors to 50 (from 15) years, required a more rapid screening of investment applications in terms of specific number of days, decentralized investment approvals to the provinces for smaller size investment applications, and made more explicit and clear the guidelines on land rights and uses. Nevertheless, these revised Laws fall short of their comparators: approval is still very discretionary; even if discretion will be exercised quickly, decisions do not follow a negative list of sectors and there are not adequate dispute resolution processes. Also, the availability of incentives for investors is not sufficiently circumscribed by a central control, to ensure that the tax base is not eroded. Measures have been also taken to attract FDI, through the creation of a one-stop service.

The Ministry of Commerce has also initiated the process of revising the Enterprise Law and the plan is to streamline the business registration process significantly so as to make process of starting a business more automatic and speedier. Mekong Project Development Facility (MPDF), a part of the World Bank Group, is supporting the Ministry to do so. The World Bank has also made an

assessment of the policy environment in 5 selected provinces for private business, both starting and operating businesses outside Vientiane capital.

The Ministry of Commerce also issued PM Decree on Trade Competition whose effectiveness in 2005 removed all restrictions on the movement of goods across provinces. This, if appropriately enforced should enhance market integration and ensure that all provinces have access to the nearest source of goods and services easily.

For background on measures taken in previous years please refer to the Annex – Box 5.

PART III – DONOR ASSISTANCE TO THE REFORM AGENDA

Lao PDR has a high dependence on external support, some of which go to technical assistance to support the reforms discussed in earlier parts of the Monitor. This Part records and reports the technical assistance and other support that the donors are currently providing to the Government's policy reform agenda and is based on information provided by donors to us when we requested for such information.

3.1 Public Sector Governance

UNDP, European Union (EU), Japan, France, Sweden and the ADB are the donors providing support to various aspects of public sector governance. This covers public administration, including National Assembly, decentralization, public financial management, as well as legal and judicial reform.

UNDP and Other Donors

Governance and Public Administration Reform GPAR Central Phase II. (Total US\$1.97m: UNDP-US\$0.54m and SDC-US\$1.35 2001-2006). During the first phase, the project had aimed at generating a high degree of understanding and commitment to the reform concept at senior political and bureaucratic levels of the government. Phase II focuses on strengthening the government's capacity to implement GPAR by supporting: (1) Strategic Management of the GPAR Program, (2) Capacity Development of the Cabinet of the Prime Minister's Office, (3) Priority Civil Service Reforms, (4) Implementation of the Decentralization Policy, (5) Targeted Central and Local Administrative Improvements, and (6) Priority GPAR Related Training.

Luang Prabang Provincial Pilot. (Total US\$0.998m: UNDP-US\$0.12 m; SIDA-US\$1.1 m, 2002-2005). The purpose is to assist the Luang Prabang authorities in the design and implementation of a better local governance system, in order to provide cost-effective services to the population. This includes Strengthening Organisational Development and Human Resources Management, Improving Financial Management, Developing a Model Office Environment, Assessing Service Delivery.

The GPAR UNV project - UNV Support to Decentralised Governance for Poverty Alleviation (UNV - US\$0.9m, 2003–2006). The project focuses on 3 pilot districts in Luang Prabang: Pak-Ou; Phonexay and Pakseng, and aims to train and support district and village level officials in their delivery of new tasks generated by the reform process. Additional GPAR pilots are being developed in the provinces of Saravanh (joint project with UNCDF expected to start in late 2004), Xieng Khouang (funded by SDC) and Khammouane.

- **Strengthening the National Assembly of Lao People's Democratic Republic** (US\$1.5m: EU – US\$1.12m and UNDP - US\$0.41m, 2004-2007). UNDP has been a strong partner of the National Assembly for several years, with a series of projects that have helped strengthen the Assembly with regard to the legislative process and oversight function. This project takes a longer-term strategic look at the areas of assistance needed to help the National Assembly implement its constitutional mandate.

- **Strengthening International Legal Instruments in Lao PDR.** (US\$.70m: Finland – US\$0.62m and UNDP – US\$0.08m, 2001-2004). The project aims to strengthen the capacity of the Department of Treaties and Legal Affairs in the Ministry of Foreign Affairs is

particular to enhance dissemination, enforcement and reporting mechanisms relating to international obligations of Lao PDR.

Development of Lao PDR Legal Sector Reform Program (US\$0.47m: UNDP – US\$0.27m and SIDA - US\$0.20m, 2004). This Preparatory Assistance (PA) project initiates a long-term program of support to the government for legal sector reform. It emphasizes the development of a long-term, strategic vision for legal sector reform, with improved coordination between government and development partners on such reforms.

Enhancing Access to Justice. (US\$0.22m: UNDP – US\$0.01m and DGTTT - US\$0.13m, 2004–2005). The government intends to make the Lao Bar Association (LBA),; presently supervised by the Ministry of Justice, an independent institution. This project aims to assist the government in i) strengthening the Lao Bar Association to function eventually as a professional, independent institution; and (ii) creating an enabling environment for the implementation of a legal aid system in Laos.

- ***Information and Communications Technology (ICT) for Development Digital Standardisation for Lao Information Exchange*** (UNDP: US\$.29m, 2003–2005). The project seeks to strengthen the capacities of the Lao government's Science, Technology, and Environment Agency (STEA) to establish and manage ICT standards for the country. The project consists of two components; 1) cooperation with UNDP's Asia-Pacific Development Information Programme (APDIP) sub-regional e-policy/e-strategy project; and 2) improving the utilization of the Lao language for electronic communication through the development of a standard Lao Character Set.

France

- ***Strengthening the capacities:*** of ministries through NOSPA (Foreign Affairs, Justice, Office of Public Prosecutor), (US\$1.5m, 2003-2005). Its main activities include training of trainers, seminars, study tours, scholarships, French language training and support for equipments in order to enhance capacities of MoFA's and MoJ's training centers. The project is implemented through NOSPA.

Japan International Cooperation Agency (JICA)

- ***Legal and Judicial Development*** (US\$ 4million, JICA – TCP 2003–2006). This project aims at developing human resources and the legal and judicial infrastructure with the Ministry of Justice, People's Supreme Court and Office of Public Prosecutor General. The project will support development of legal database, statute book, law textbooks and dictionaries in civil and commercial laws, prosecutor's manual, and People's Supreme Court casebook.

- ***Capacity Building in Public Investment Program Management*** (US\$ 3million, JICA – TCP 2004 - 2007). This project aims at improving overall management of domestic PIP (implemented by the Laotian budget) in cooperation with the Committee for Planning and Investment (CPI). The main activities of the project are to support (1) planning, appraisal, monitoring, and evaluation of PIP, (2) providing workshops and training (3) training officials through the implementation of the actual project in selected provinces (OJT), and (4) establishing the organization-based coordination network in PIP management.

- ***Macroeconomic Policy support for Socio-Economic Development.*** Phase 2 – MAPS 2 (US\$ 1.2million, JICA – TCP 2003 - 2005). MAPS 2 intends to enhance the capability of the Lao Government to formulate the proper macroeconomic policies based on the appropriate process of research and data analysis. In collaboration with National Economic Research Institute(NERI), CPI, this project organizes four working groups among the ministries concerned focuses on following four key issues; (1) Agriculture and Rural Development, (2)Promotion of SMEs, (3)Improvement of Financial Sector, (4) Integration into Regional Economy.

New Zealand

- ***English Language Training for Officials*** (US\$0.284m, Ongoing). ELTO is a long standing project that is providing English language training to mid level officials. The project moved into a new phase at the beginning of 2003.

3.2 Reform of State Owned Enterprises & Financial Sector

ADB

- *Banking Sector Reform Program including strengthening governance of SCBs*
- *Rural Finance Development Program & TA*
- *Institutional Strengthening for Rural Finance*
- *Catalyzing Microfinance for the Poor*

European Union (EU)

- *EuroTAL Bank Training Project*

IMF

- *Poverty Reduction & Growth Facility- PRGF expired. Two-mission surveillance now.*

SIDA

- *Strengthening Fiscal Management -*

World Bank

- *Financial Management & Capacity Building Credit(\$8 mln)*
- *Financial Accountability IDF Grant (\$0.3 mln)*
- *First Poverty Reduction Support Operation (PRSO-1) - \$10 mln*

3.3 Trade Reform

ADB

- *Integrating Poor in Regional Trade through Standard-Setting for Private Sector Development.*
- *Marketing Support for the Organic Produce of Ethnic Minorities*

European Union (EU)

- *AsiaInvest - Export Challenge*
- *Multrap (Multilateral Trade Assistance Project) - Support for Lao PDR's accession to WTO*

International Trade Center (ITC)

- *Support to Trade Promotion and Export Development*

UNCTAD (funded by France)

- *Train For Trade:*

UNDP and AusAID

- *Support for Lao PDR's Integration into the International Trading System*
- *Enabling more effective Integration of Lao PDR into the ASEAN*

USAID

- *Support to Implementation of Bilateral Trade Agreement*

3.4 Private Sector

PRIVATE SECTOR DEVELOPMENT

ADB

- *Smallholder Development Project*
- *Improving the Climate for Investment and Productivity*
- *Small & Medium Enterprise and Private Sector Development Project*
- *GMS: Mekong Tourism Development Project*

Germany (GTZ)

- *Human Resource Development for Market Economy*

JICA

- *Macro Economic Study Project*
- *Lao-Japan Human Resource Center Development Project*

MPDF (IFC, WBG)

- *Mekong Private Sector Development Facility.*

SNV - Netherlands Development Organization

- ***SNV's private sector development program***

Switzerland (SDC)

- *The Promotion of Organic Farming and Marketing in Lao PDR*
- *Small-scale Agro-enterprise Development in Rural Uplands of Lao PDR*

NZAID

National Tourism Authority of Lao PDR – UNESCO Nam Ha Ecotourism Project,

- *Village Assisted Mine Clearance in the Lao PDR*

World Bank and AusAID (US\$47.66m)

- *The First Land Titling Project*
- *The Second Land Titling*

ANNEX BOXES ON ACTIONS TAKEN IN PREVIOUS YEARS

Box 1. GOL Actions to Improve Public Expenditure Management

Measures taken in 2002

- Decree No. 57/PM on the Management of Public Investment, issued on May 22, 2002. The decree requires that PIP submissions for new public projects in excess of 1 billion kip in the FY02/03 budget include estimates of associated recurrent costs during the operating period. The rationale is that it will help Lao PDR correct the imbalance between investment and recurrent expenditures in the budget, which at present is heavily skewed towards the former, by clearly identifying recurrent cost requirements.
- FY 2000/01 outcome and FY 2001/02 budget published in April 2002 with classification by ministry, province, and services. The publication of the budget in the Official Gazette enhances budget transparency. However, the budget classification remains incomplete. The current budget nomenclature allows an economic classification and some functional accounts on an ad-hoc basis. The budget classification system needs to be revised to allow for the identification of administrative units and level of government (central, provincial, district) classification, and to be harmonized with the accounting nomenclature.
- The Government adopting the Accounting Regulations in July 2002 to implement Decree 20/PM on General Regulation of Public Accounting, to enhance financial accountability and transparency as well as internal financial control over revenues and expenditures. The regulations cover basic features of internal control that must be established and maintained in each ministry, province, district and agency, and also provide financial statements of the Government which are to be submitted to the National Assembly at the end of each FY.

Measures taken in 2003

- Increases in transparency was maintained for the second year by the publication of the FY 2001/02 budget outturn and FY 2002/03 budget-plan in April 2003 in the Official Gazette, with classification by ministry, province, and sectors, a summary of which is provided in Table 3.
- The Procurement Monitoring Office (PMO) was established within the Ministry of Finance, to oversee the implementation of better procurement processes and to assist in related capacity building activities. The office is operational in its new premises. In addition, the office is revising the implementing regulations, which is expected to be completed by the end of the year.
- New Procurement decree 03/PM issued in December 2003 and the Implementing Regulations approved by Prime Minister in June 2004 - they have improved clarity of language and specified conditions for actions.
- A methodology for estimating the recurrent costs has been developed for core construction projects in the PIP and was applied to actual PIP projects in the training of staff from CPC and MOF around middle of 2003. Of the 149 new construction-related projects in excess of 1 billion kip, (90 percent of new projects are construction-related), recurrent costs were estimated for 96 of them.

Box 2. GOL Actions on SOE Reform

Measures taken in 2001

- The Business Promotion Office (BPO) - was established in the Office of Prime Minister to centralize the restructuring of SOEs, and a Minister was named to head the office;
- Governance of the largest loss-making state-owned enterprise, Bolisat Phatthana Khet Phoudoi (BPKP) was transferred from the Ministry of Defense to the Ministry of Finance, with BPO charged with the restructuring of BPKP;
- Management audits were undertaken in Lao Aviation and BPKP, leading to change in top management of Lao Aviation;
- Financial Recovery Plan (FRP) for EdL agreed with donors and its implementation was initiated;
- A new telecommunication law, passed in April 2001, laid the framework for telecom regulations, opening the sector to private participation, beginning November 2001.

Measures taken in 2002

- Decree No. 54/PM, May 2002, on Management of State-Invested Enterprises, and its Implementing regulations, Dec 2002, clarified the role and responsibilities of the Directors and managers of SOEs and their financial reporting requirements and provided guidance on capital investment in SOEs, procurement/transfer/replacement of assets, and the treatment of dividends, and; outlined sanctions for SOEs violating the regulations.
- Memoranda of Understanding (MOU) dated May 15, 2002 on the restructuring of BPKP, Lao Aviation, Nam Papa Lao, and Pharmaceutical Factory No. 3, setting out the broad parameters of the proposed

restructuring, to be used as the basis for preparing detailed multi-year restructuring plans.

- Top management of BKKP and Pharmaceutical Factory No. 3 also changed to facilitate SOE restructuring.
- Letter of the Minister of Finance No. 618/MOF dated April 10, 2002 on new electricity tariff policy;
- White paper on water tariff policy; a draft 'Water Supply Authority (WASA) Charter' on Regulation of Water Supply Operations" is also under review. This is expected to give WASA the authority to function as the water supply sector regulator.

Measures taken in 2003

- Tariff increases in tariffs for Lao Airlines, electricity, telecommunications, water.

Measures taken in early 2004

- Further increases in tariffs for water, electricity, telecommunications and aviation.
- Explicit Tariff Policies were adopted – PM Notices approving Ministry proposals – for telecommunications, water and aviation, though on the latter few details given the impending joint-venture of Lao Airlines.
- The Prime Minister's Notice No. 059/CPMO dated 15 January 2004 adopted the key elements of the restructuring plans for four SOEs, including key principles of such restructuring. The subsequent four Implementing Guidelines/Instructions issued to all relevant agencies on April 29, 2004 by the Minister in the Prime Minister's office in charge of SOE restructuring set-out detailed actions, the institutional arrangements and agencies responsible for their implementation, transparent monitoring and evaluation procedures which include external audits and a specific timetable for 2004 and 2005 for their implementation.
- The State Asset Management Board (SAMB) has, in early 2004, completed its development of the data-base and the classification of all SOEs by performance. A system for collecting data and maintaining the data-base for annual monitoring of SOE performance has been established, based on the Implementing Regulations to the Decree on Management of State-Invested Enterprises, Decree No. 54/PM dated May 9, 2002.
- Memorandum of Understanding (MOU) for Restructuring have been adopted for five additional SOEs, namely, DAFI, Lao State Fuel Enterprise, Lao Export-Import Trading Company, Bridge-Road Construction Company No. 13 and Agro-industrial Development Company (DAI).

Box 3. GOL Actions in the Banking Sector

Measures taken in 2001

- Notice No. 90/BFSD dated March 19, 2001, requiring a commercial bank to make general provision from 0.5% to 1% of performing loans; Notice No. 209/BFSD dated June 15, 2001, reiterating that a commercial bank shall comply with Regulation No. 03/BOL, which set ceiling for lending at 60% of collateral value and for lending to a single borrower at 10% of the bank's capital, and a commercial bank shall comply with Regulation No. 98/BOL on loan classification, suspension of accrued interest income on a loan which becomes overdue for longer than 90 days, and restriction on new lending to a defaulted borrower;
- Instruction No. 176/BOL dated June 30, 2001, reiterating general reserve requirement and compliance with Regulation No. 98/BOL on loan classification;
- Notice No. 158/AMD dated July 3, 2001, which restricts SCBs to make a policy lending (for an infrastructure project, promotion of export and import substitute, and rice plantation) and focus on loan recovery;
- Instruction No. 195/BOL dated July 6, 2001 and letters to BCEL, LMB, LXB No. 263/BFSD dated August 6, 2001, which distinguish required provision on stock (subject to regulatory forbearance) and flow (in accordance with Regulation No. 98/BOL)i, reiterate SCBs to stop accruing interest income on NPLs, require SCBs to submit to BFSD a report on directed lending.

Measures taken in 2002

- Instruction 01/BOL dated Jan. 10, 2002 on notional capital, credit to large customers, and level of NPLs;
- Instruction No. 03/BOL dated March 14, 2002, which restricts SCBs to grow their risk portfolio if flow NPL ratio exceeds 15% and reduce the branch approval limits. This regulation is aimed to stop further deterioration of SCBs' assets;
- Notice No. 15/CIMD dated April 24, 2002, which gives clarification of Instruction No. 03/BOL;
- Notice No. 566/MOF dated March 31, 2002 on autonomy of SCBs. The objective of this notice is to ensure that SCBs have full autonomy in operating their banks on a commercial basis;
- The Rural and Micro Finance Committee (RMFC) was established on Feb.15, 2002 under Bank of Lao PDR (BOL) to make assessment of the rural and micro-finance industry, formulate a policy statement, and develop an action plan for the implementation of a rural and micro-finance reform program;

- The External NPL Collection Committee (ECC) was established under BOL with the mandate to support debt restructuring on a voluntary basis by SCBs and debtors; Signed Memoranda of Understanding for Restructuring (MOUR) for each SCB dated March 31, 2002, stating the basic principles under which the restructuring will be conducted;
- Two SCBs, Lao Mai Bank and Lane Xang Bank, were merged into the “Lao Development Bank” (LDB) and has been operating as such since the end of 2002.

Measures taken in 2003

- Governance Agreement between Bank of the Lao PDR, Ministry of Finance, each SCB, its Board of Directors, and the management was signed in March 20, 2003. The Agreement is aimed to restructure and strengthen SCBs.
- International bank advisors (IBA) were recruited by BOL to assist in restructuring and strengthening SCBs. IBAs have been working with SCBs since April 2003.
- Regulation No. 6/BOL replacing Regulation No. 98/BOL on loan classification and Regulation No. 5/BOL replacing Regulation No. 178/BOL on foreign currency exposure. Regulation No.3/BOL on lending limits is amended. The amendment improves and strengthens existing prudential regulations, which are currently ambiguous. BOL are reviewing the drafts, which may be implemented in 2004.
- Letter No. 17 and 18/BFSD, dated February 26, 2003, Letter No. 053/BFSD, dated July 30, 2003, Letter No. 092/BFSD, dated October 23, 2003 and Letter No. 120 and 121/BFSD, dated December 5, 2003 instructing BCEL and LDB to limit their net new lending since their NPLs exceed 15%. Letter No.17 and 18/BFSD also requesting both SCBs to follow Instruction 01 and 03 closely since they exceeded the concentration limit without prior approval by BOL. These letters enforce SCBs to comply with the prudential regulation and restricted banking regime to avoid further deterioration in their portfolio.
- Notice No. 1760/PMO dated December 17, 2003 informing the MOF that the Prime Minister’s Office endorsed in principle the rural and microfinance policy and action plan in December 2003. This will serve as the building blocks for developing rural financial services for the poor.
- The MOF has issued “triangle” bonds to SCBs, which are designed to resolve NPLs caused by government arrears. 120 billion kip was issued in July 2003 with one-year tenure and 11% semi-annual coupon. The second lot of 120 billion kip was issued in September 2003 with two-year term and 11% semi-annual coupon.
- The draft amendment of the Decree Law on Commercial Banks was approved by BOL and is being reviewed by Ministry of Justice in early 2004.

Box 4. GOL Actions towards Trade Promotion

Measures taken in 2003

- Coverage of import and export restrictions is significant³. Notice 204 specifies that a license from the Minister of Commerce/provincial offices of MOC is needed to import the following: Petrol and gas; Cars and parts for assembling vehicles of any type other than tractors⁴; Cement; Steel; Jewelry; any of 17 foodstuffs that include all meats, eggs and poultry, animal feeds, sugar, canned foods, food coloring or seasoning, soft and alcoholic drinks (including beer) and animal medicines; seeds; Videos, movies, gambling machines, satellite TV receivers and telecommunications equipment; Sporting guns.
- In January 2003, of the 1291 items on Lao’s Temporary Exclusion List (TEL), 436 items were transferred to Inclusion List (IL) of AFTA thereby putting 71 percent of all items and 45 percent of all dutiable imports by value in the Inclusion List⁵.
- On September 18, 2003 the Lao and US governments signed the first US-Lao Bilateral Trade Agreement (BTA) in Vientiane, which will go into effect after the US Congress enacts legislation authorising normal trade relations (NTR) between the two countries.
- PM Decision No.14/PM of February 28, 2003 allowed the establishment of duty-free warehouses in Vientiane and Savannakhet (at Seno special economic zone) to facilitate the import processes.
- Supplementary Guiding Order No.530 of May 10, 2004, on business registration, has established sunset provision of two days for registration of local businesses in trade sector at one of the following three levels: central (MOC), provincial and district. However, the application must include: (1) an application form, (2) personal biography, (3) a statement of criminal records No.3, a copy of ID card and three pieces of 3x4 photo, (4) financial statement, (5) charter-by-law approved by trade agency (for entity as company only). Thus the application requirements remain quite time-consuming in terms of other formalities.
- Annex to the Supplementary Guiding Order No.530 (May 10, 2003) on business registration No. 538/MOC dated May 13, 2003 provides a division of business registration approval between different levels of government agencies: (1) MOC registers foreign companies (with registered capital from and over 200

³ Each year through Notices to implement the general Decree No.205 of the Prime Minister issued on 11 October 2001 on this issue. Notice 203 of February 2003 defines the lists of prohibited imports and exports and these appear to be relatively uncontroversial bans related to public safety and morals plus those related to logging & raw timber exports.

⁴ Licensing of vehicles is now used only mainly as a registration device as importers can import as many as they want.

⁵ Under AFTA, Lao PDR is committed to move all the items from its Temporary Exclusion List (TEL) to the Inclusion list (IL) by the beginning of 2005 and to reduce the CEPT rates on all IL items to between zero and 5 percent by the beginning of 2008.

thousands US\$), enterprises dealing with imports of vehicles and fuel and exports of wood and wood products, state enterprises and joint ventures established at central level: (2) provincial trade authorities provide registration to foreign investors (with registered capital below 200 thousands US\$), enterprises in agricultural, industrial and services sectors, trading firms, state enterprises and joint ventures established by local governments; (3) district offices can register and manage retail stores, shops and other small services.

- Decree No. 125/PM of July 24, 2003 on organisation and operations of Lao National Chamber of Commerce and Industry (LNCCI) (replacing the decree No.175/PM of 20 August 1998 on areas of responsibilities of LNCCI) redefines the role, functional responsibilities, organisational structure and financial matters of LNCCI. LNCCI is an independent organisation that represents the business communities and acts as a bridge linking between the public and private sectors and brings together continuing dialogues between the government agencies and business communities. On behalf of its members, LNCCI negotiates with GOL and foreign partners on trade, industrial and services issues and establishes its representative offices abroad. It issues the certificate of origin to exporters and approves the establishment of business groups in the country. Being financially independent, LNCCI gets supports from its members (member fees), its own services (issuance of certificate, training and advisory services, trade exhibitions, etc.), the government as well as from individuals and local and international organisations.

Measures taken in early 2004

- Ministerial Guideline No.04/MOC of January 5, 2004 on promoting commodity production. It has defined the following goals for the next few years: (1) meet domestic demands and substitute imports (especially food, raw materials, construction materials and other consumer goods that have potential), (2) increase exports, especially to ASEAN and other neighbour countries (of agricultural and forestry products, and wood), (3) maintain market dynamics, by favouring demands and supplies to support economic growth. This guideline also provides some significant implementation measures: (1) create awareness among Lao people at all levels of the importance of the transition from a self-sufficient economy to market-oriented one, (2) improve existing regulations and procedures to encourage the production of commodities and facilitate domestic trade and exports, (3) increase roles and participation of business communities from all economic sectors in the commodity production process, (4) attract more FDI for commodity production and leverage the Lao economic potential, especially in the area of natural resources and human capital.
- In January 2004, 422 items were moved from TEL to IL bringing coverage of IL to 84 percent of import tariff lines.
- PM Decree No.15 of February 04, 2004 on trade competition. It will be effective on August 1, 2004, and has provided key principles to regulate monopolistic practices, and to promote fair competition and a level playing field for all players. The decree has identified the government agencies responsible for the monitoring of competition, and defined roles and responsibilities to ensure free market and guarantee the participation of various sectors of the economy.

Box 5. GOL Actions to Improve Private Investment Climate

Measures taken in 2001

- GOL took steps towards improving transparency and simplifying the investment registration processes. A number of websites (inter alia: www.invest.laopdr.org, www.moc.gov.la) have been set up to provide basic information about the country's legal framework, business and investment related laws, sector and industry information and other services.
- Decree No.46/PM March, 2001 on the Implementation of the Law on the Promotion and Management of Foreign Investment provides basic guidelines for improving registration and speeding up approval processes for foreign investment. Based on this decree, total approval time for different types of projects has been reduced from 90-180 days to 45-60 days.
- On land, PM Decree 237/PM 2001 provides more clarity in the institutional setup and main functions and activities of the Department of National Land Use Planning and Development (DONLUPAD), which is responsible for the coordination of land-related policy⁶ and inter-agency consultations on appropriate institutional arrangements.

Measures taken in 2002

⁶ The Land Law 01/97/NA (April 12, 1997) repeals a number of previous laws (1979, 1989, 1992) and serves as the new basis for land administration and management in Lao PDR, defining institutional responsibilities for land administration and registration (especially for eight categories of land in Lao PDR: agricultural, forest, construction, industrial, communication, cultural, water-area land and land for national defence and peace-keeping), and (2) sets out the basic rights and obligations of the land user.

PM Decree 22/PM of 1999 is on implementation of the 1997 Land Law.

Presidential Decree on Land Tax (03/PDR of August 12, 2000) provides new guidelines for land tax collection and management, with detailed tax rates for each type of land and its location.

- Further to Decree No.46/PM, Decision of the Chairman of CIC, dated 27 February 2002, has decentralized approval of foreign investment projects, extension of foreign activities and establishment of branches of foreign companies in Lao PDR. It defines four size-classes of foreign investment based on value: (1) equal or less than US\$1m, (2) from above US\$1m to US\$5m, (3) from above US\$5m to US\$10m, (4) Above US\$10m. Approval of FDI equal or less than US\$1m can be done at the provincial level by all provinces. However, in large provinces, such as Vientiane Municipality, Savannakhet, Champasack and Luangprabang, the ceiling for provincial approval is US\$2m and less).

Measures taken in 2003

- PM Decree dated 23 April 2003, on roles and responsibilities of CIC at central and local levels. The decree provides local governments with new autonomy over investment and defines organisational structure, roles and responsibilities of CIC and other relevant line-ministries and agencies at central and local levels. It serves as a strategic guidance for CIC at all levels for decision-making process including approvals, promotion, management and monitoring of domestic and foreign investment. The effective implementation of the decree would contribute to the improvement of the investment environment in the country.
- Amendment of Lao constitution, especially with regard to chapter 2 on Social and Economic System. The new text states that GOL promotes every economic sector, including domestic and foreign investment, a modern industry, enterprises and services in order to accelerate economic growth of the country. The constitution further confirms the Government intention to guarantee interest in property and lawful capital of all investors.
- Publication of Quarterly Newsletter by DDFI. The government issued in July 2003 the first Quarterly Newsletter, to disseminate FDI information to investors and to promote foreign investment. The Newsletter provides recent updates on investment regulations (mainly on decentralized management and approval process at the central and provincial levels), tips for applications, investment incentives for various priority sectors and investment zones, and data on the cost of doing business in the country (business costs – land, office space, factory building, warehouse; and production costs – labor, utilities, i.e. electricity, water, fuel/gas, and telephone).
- PM established National Land Policy Committee (NLPC) on March 25, 2003, representing a number of line ministries/agencies involved in land administration and management, and providing an effective oversight mechanism to resolve policy issues as they arise and to facilitate the development of a comprehensive land policy framework. DONLUPAD is assigned as the secretariat of NLPC.

Measures taken in early 2004

- PM Decree No. 42/PO of April 20, 2004 on Promotion and Development of Small and Medium Sized Enterprises, defines key policies and an action plan for SME promotion and development, including the establishment of SME Development Funds and supporting organizations (the SME Promotion and Development Committee and its permanent Office and Executive Committee). It also defines regulations, methods and measures needed to promote SMEs, the expansion of commodity production, and trade and service activities. The policy gives priority to creating an enabling regulatory environment, enhancing competitiveness, expanding markets (domestic and international), improving access to financing and developing both entrepreneurship and an entrepreneurial culture in the country.



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